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Department of the Treasury  
Washington, DC 20224

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Person To Contact:  
 , ID No.

Telephone Number:

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Date: September 27, 2007

### LEGEND:

Corporation:

State:

Address:

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d:

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f:

Dear :

We received a letter from your authorized representative requesting rulings regarding the application of § 216 of the Internal Revenue Code. This letter responds to that request.

The represented facts are as follows. Corporation is a cooperative housing corporation organized under the laws of State. Corporation owns the apartment building located at Address ("Building"). Building contains a residential units and b commercial units ("Commercial Units"). Currently, c shares of common stock are authorized, d of which are issued and allocated to the residential units. Stock has not been allocated to the Commercial Units. The Commercial Units are currently leased by Corporation to e commercial tenants.

Corporation proposes to issue f shares of its authorized but unissued stock and allocate those shares to the Commercial Units. A proprietary lease will entitle the owners of the stock, as against Corporation, to occupy the space for dwelling purposes solely by reason of the ownership of the shares.

Corporation further proposes to distribute to its current tenant-stockholders the f

shares of stock that will be allocated to the Commercial Units. The tenant-stockholders then plan to contribute the f shares of stock allocated to the Commercial Units to a limited liability company (LLC) in exchange for proportionate shares of membership interests in the LLC.

Corporation represents that the local zoning law and building regulations currently permit modification of the Commercial Units to residential use as a matter of right. Corporation has submitted facts and representations to show that it would be reasonable to convert the Commercial Units to residential use. The size and location of the Commercial Units are such that, with certain modifications, they could be converted into residential apartments.

You have specifically requested the following rulings:

- 1) Neither the issuance of f shares of Corporation stock to be allocated to the Commercial Units nor the possible nonresidential use of the Commercial Units will prevent Corporation from qualifying as a cooperative housing corporation within the meaning of § 216(b)(1).
- 2) For purposes of § 216(b)(1)(D), the income Corporation receives from the LLC pursuant to stockholder assessments made by Corporation will be income derived from tenant-stockholders.
- 3) The proposed stock distribution by Corporation shall not be treated as a distribution to the tenant-stockholders to which § 301 applies by reason of § 305(b) or § 305(c), but rather will constitute a distribution to which § 305(a) applies. Thus, the distribution shall not result in taxable income to any of Corporation's tenant-stockholders.
- 4) No gain or loss shall be recognized to Corporation upon the distribution of stock in accordance with § 311(a) or § 311(b).
- 5) The cost or other basis of the stock in Corporation held by a tenant-stockholder immediately prior to the distribution of the shares shall be allocated between the stock held by such tenant-stockholder immediately prior to the distribution of the shares and the shares received in the distribution in proportion to the fair market value of the shares of each immediately after the distributions by reason of § 307(a) and § 1.307(a) of the Income Tax Regulations.
- 6) The contribution by the existing tenant-stockholders of the new shares to the LLC in exchange for proportional percentage interests of the LLC membership interests shall not be taxable to the tenant-stockholders or the LLC pursuant to § 721(a).

- 7) The basis in the LLC membership interest received by each tenant-stockholder shall be the same as the basis such tenant-stockholder had in the shares contributed to the LLC pursuant to § 722.
- 8) The LLC's basis in the shares received by the LLC from the existing tenant-stockholders shall be equal to the cumulative bases that these tenant-stockholders had in the contributed shares prior to their contribution to the LLC by reason of § 723.

### **Ruling Requests 1 & 2**

Section 216(b)(1) provides that the term "cooperative housing corporation" means a corporation -- (A) having one and only one class of stock outstanding, (B) each of the stockholders of which is entitled, solely by reason of his ownership of stock in the corporation, to occupy for dwelling purposes a house, or an apartment in a building, owned or leased by such corporation, (C) no stockholder of which is entitled (either conditionally or unconditionally) to receive any distribution not out of earnings and profits of the corporation except on a complete or partial liquidation of the corporation, and (D) 80 percent or more of the gross income of which for the taxable year in which the taxes and interest described in § 216(a) are paid or incurred is derived from tenant-stockholders.

Section 216(b)(2) provides that the term "tenant-stockholder" means a person who is a stockholder in a cooperative housing corporation, and whose stock is fully paid-up in an amount not less than an amount shown to the satisfaction of the Secretary as bearing a reasonable relationship to the portion of the value of the corporation's equity in the houses or apartment building and the land on which situated which is attributable to the house or apartment which such person is entitled to occupy.

Section 1.216-1(e)(2) provides, in relevant part, that in order to qualify as a "cooperative housing corporation" under § 216, each stockholder of the corporation, whether or not the stockholder qualifies as a tenant-stockholder under §§ 216(b)(2) and 1.216-1(f), must be entitled to occupy for dwelling purposes an apartment in a building or a unit in a housing development owned or leased by such corporation. The stockholder is not required to occupy the premises. The right as against the corporation to occupy the premises is sufficient. Such right must be conferred on each stockholder solely by reasons of his or her ownership of stock in the corporation. That is, the stock must entitle the owner thereof either to occupy the premises or to a lease of the premises. The fact that the right to continue to occupy the premises is dependent upon the payment of charges to the corporation in the nature of rentals or assessments is immaterial.

Rev. Rul. 74-241, 1974-1 C.B. 68, provides that, for purposes of § 216(b)(1)(B), the term "apartment in a building" means an independent housekeeping unit consisting of one or more rooms containing facilities for cooking, sleeping, and sanitation normally

found in a principal residence.

Rev. Rul. 90-35, 1990-1 C.B. 48, provides that Rev. Rul. 74-241 does not require that a unit presently contain all the facilities normally found in a principal residence in order to constitute an apartment in a building for purposes of § 216(b)(1)(B). A unit will be treated as meeting that definition if: (1) the stockholder is entitled to convert the unit to an apartment, as defined in Rev. Rul. 74-241, solely by reason of ownership of stock in the cooperative housing corporation; (2) the conversion of the unit would be reasonable under all the facts and circumstances, including structural feasibility and costs; and (3) the applicable zoning, building, and fire codes permit both the conversion and residential use of the unit as a matter of right.

Applying the above standards to the facts and representations submitted and subject to the limitation below, we conclude that provided Corporation satisfies the requirements of § 216(b)(1)(A), (B), (C) and (D), the issuance of stock by Corporation to be allocated to the Commercial Units and the possible non-residential use of the Commercial Units will not prevent Corporation from qualifying as a cooperative housing corporation within the meaning of § 216(b)(1).

We also conclude that the purchaser of the stock of Corporation attributable to the Commercial Units will qualify as a "tenant-stockholder" for purposes of § 216(b)(2), provided such stock is fully paid up in an amount which bears a reasonable relationship to the portion of the value of Corporation's equity in the building and land which is attributable to the unit which the purchaser is entitled to occupy.

### **Ruling Requests 3, 4 & 5**

Section 305(a) provides the general rule that except as otherwise provided, gross income does not include the amount of any distribution of the stock of a corporation made by the corporation to its shareholder with respect to its stock.

Section 305(b) provides that distributions in lieu of money, disproportionate distributions, distributions of preferred stock on common stock, distributions of common and preferred stock, distributions on preferred stock, and distributions of convertible preferred stock are treated as § 301 distributions of property.

Under §§ 305(c) and 1.305-7, a change in conversion ratio, a change in redemption price, a difference between redemption price and issue price, a redemption that is treated as a distribution to which § 301 applies, or any transaction having a similar effect on the interest of any shareholder may be treated as a distribution with respect to any shareholder whose proportionate interest in the earnings and profits or assets of the corporation is increased by such change, difference, redemption, or similar transaction.

Section 311(a) provides that, except as provided in § 311(b), no gain or loss is recognized to a corporation on the distribution (not in complete liquidation) with respect to its stock of (1) its stock (or rights to acquire its stock), or (2) property. Section 311(b) provides that gain is recognized by a corporation if it distributes property to a shareholder and the fair market value of such property exceeds its adjusted bases.

Sections 307(a) and 1.307-1(a) provide that if a shareholder receives stock as a distribution on stock previously held and under § 305 such distribution is not includible in gross income, then the basis of the stock with respect to which the distribution was made shall be allocated between the old and the new stocks in proportion to the fair market values of each on the date of the distribution.

Based on the foregoing, we conclude that the proposed distribution by Corporation of the shares will be a nontaxable stock distribution excluded from the gross income of the tenant-stockholders under § 305(a). We also conclude that the proposed distribution of the shares will not result in the recognition of gain or loss by Corporation pursuant to § 311(a)(1).

Further, the cost or other basis of the stock in Corporation held by a shareholder immediately prior to the distribution of the shares will be allocated between the stock held immediately prior to the distribution of the shares and the shares received in the distribution in proportion to the fair market values of each immediately after the distribution in accordance with § 307(a). Additionally, the proposed distribution of the shares of stock will not diminish the earnings and profits of Corporation available for later dividend distributions within the meaning of §§ 316, 1.312-11(b) and (c).

### **Ruling Requests 6, 7 & 8**

Section 351(a) provides that no gain or loss will be recognized if one or more persons transfer property to a corporation solely in exchange for stock in the corporation and immediately after the exchange the transferors are in control (as defined in § 368(c)) of the corporation.

Section 351(e)(1) provides that § 351(a) will not apply to a transfer of property to an investment company.

Section 1.351-1(c)(1) provides that a transfer of property will be considered to be a “transfer of an investment company” if (1) the transfer results, directly or indirectly, in diversification of the transferors' interests, and (2) the transferee is (a) a regulated investment company, (b) a real estate investment trust, or (c) a corporation more than 80 percent of the value of whose assets are held for investment and are readily marketable stocks and securities, or interests in regulated investment companies or real estate investment trusts.

Section 1.351-1(c)(3) provides that stocks and securities will be considered

readily marketable if (and only if) they are part of a class of stock or securities which is traded on a securities exchange or traded or quoted regularly in the over-the-counter market. For purposes of § 1.351-1(c)(1)(ii)(c), the term “readily marketable stocks or securities” includes convertible debentures, convertible preferred stock, warrants, and other stock rights if the stock for which they may be converted or exchanged is readily marketable. Stocks and securities will be considered to be held for investment unless they are (i) held primarily for sale to customers in the ordinary course of business, or (ii) used in the trade or business of banking, insurance, brokerage, or a similar trade or business.

Section 721(a) provides that no gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

Section 721(b) provides that § 721(a) shall not apply to gain realized on a transfer of property to a partnership which would be treated as an investment company (within the meaning of § 351) if the partnership was incorporated.

In the present situation, the shares allocable to the Commercial Units are not interests in regulated investment companies, interests in real estate investment trusts, or part of a class of stock which is traded on a securities exchange or traded or quoted regularly in the over-the-counter market. Because the current tenant-stockholders will be contributing nonmarketable securities in exchange for all of the interest in the LLC, the LLC will not constitute an investment company within the meaning of § 1.351-1(c)(1). Thus, the exception of § 721(b) will be inapplicable and the contribution will qualify for nonrecognition under § 721(a).

Section 722 provides that the basis of an interest in a partnership acquired by a contribution of property, including money, to the partnership shall be the amount of such money and the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under § 721(b) to the contributing partner at such time. Because the tenant-stockholders are contributing only shares in Corporation, and there will be no gain under § 721(b), each tenant-stockholder will take a basis in the LLC interest that is derived from the basis of the contributed shares.

Section 723 provides that the basis of property contributed to a partnership by a partner shall be the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under § 721(b) to the contributing partner at such time. Because there will be no gain under § 721(b), the LLC will take the contributed shares with the basis of those shares in the hands of the respective contributors.

Accordingly, we conclude that the contribution by the tenant-stockholders of the

shares of stock allocated to the Commercial Units to the LLC in exchange for LLC membership interests will not be taxable to the tenant-stockholders nor to the LLC pursuant to § 721(a). Further, the basis in the LLC membership interest received by each tenant-stockholder will be the same as the basis the tenant-stockholder had in the shares contributed to the LLC pursuant to § 722. Finally, the LLC will take a carryover basis in each share of stock it receives from the tenant-stockholders pursuant to § 723.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Further, we express or imply no opinion whether Corporation otherwise meets the requirements of § 216.

Specifically, we express or imply no opinion as to whether Corporation meets the requirements of § 216(b)(2) concerning whether the stock bears a reasonable relationship to the portion of the value of the corporation's equity in the building and land which is attributable to the unit which the purchaser is entitled to occupy.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

In accordance with the Power of Attorney on file with this office, we are sending a copy of this letter to your authorized representatives. A copy of this ruling must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Joseph H. Makurath  
Senior Technician Reviewer, Branch 6  
(Passthroughs & Special Industries)